

TEACHERS' RETIREMENT BOARD

REGULAR MEETING

SUBJECT: Update on Federal Legislation

ITEM NUMBER: 9b

ATTACHMENT(S): 5

ACTION: X

MEETING DATE: May 8, 2003

INFORMATION:

PRESENTER: Ed Derman

ELK HILLS COMPENSATION

The California State Teachers' Retirement System (CalSTRS) has successfully persuaded Congress to appropriate each of the last five annual installments for a total of \$180 million, and is now working on appropriating funds for the sixth annual installment of Elk Hills' compensation. In an effort to help secure the sixth installment of Elk Hills compensation, CalSTRS, with the strong support of the Chairman of the House Ways and Means Committee, Bill Thomas, has secured the signatures of all 52 Members of the California House delegation on a letter (Attachment 2) which has been sent to the Chairman of the House Interior Appropriations Subcommittee in support of an appropriation of \$59 million in Elk Hills compensation for fiscal year 2004. This represents the entire amount due CalSTRS in FY 2004 under the Settlement Agreement enacted as part of the FY 2000 budget, after taking into consideration a \$26 million "hold-back" awaiting final determination of the value of the land.

In contrast, the Administration has requested \$36 million for fiscal year 2004, to reflect what is, in effect, a second hold-back. This second hold-back is contrary to the terms of the Settlement Agreement. After consultation with CalSTRS, the State Attorney General, in February, sent a letter to the General Counsel of the U.S. Department of Energy (DOE) seeking an explanation for the discrepancy in the amount of the sixth installment requested by the Administration. The purpose for the letter is to remind the DOE of the full amount due from the Elk Hills School Lands Fund and to make clear that CalSTRS expects to receive no less than the full amount due. CalSTRS still is awaiting a final response. CalSTRS has also prepared and filed written testimony in support of the Elk Hills appropriation with the Interior Appropriations Subcommittees of both the House and the Senate. A copy of the House statement is attached (Attachment 3).

IMPLEMENTATION OF THE SARBANES-OXLEY CORPORATE GOVERNANCE AND ACCOUNTING REFORM LEGISLATION

CalSTRS federal counsel has been providing staff with regular written updates on the implementation by the Securities and Exchange Commission (SEC) of various major components of the Sarbanes-Oxley corporate governance and accounting reform legislation. On

April 1, the SEC approved final rules under Section 301 of the Sarbanes-Oxley Act which require that the audit committee of a corporate issuer's board of directors:

- Be made up of independent directors;
- Be given direct responsibility for the appointment, compensation oversight, and continued retention of the outside auditor, who must report directly to the audit committee;
- Have the authority to hire independent counsel and other outside advisers;
- Put into place procedures for handling complaints regarding corporate accounting issues, internal controls, or the performance of the outside auditors.

SEC staff is reviewing the proposals set forth by the New York Stock Exchange and the NASDAQ market regarding listing standards for corporate governance, and may seek to make these two sets of corporate governance consistent. Currently, SEC staff are also developing other regulations and proposed rules related to the Sarbanes-Oxley legislation.

On April 15, 2003, SEC Chairman Donaldson, announced his intention to have William McDonough, the retiring Chairman of the New York Federal Reserve Bank, serve as Chairman of the Public Company Accounting Oversight Board, subject to the final vetting.

PENSION SECURITY LEGISLATION AND PENSION LIBERALIZATION LEGISLATION

On April 11, Representatives Rob Portman and Ben Cardin introduced H.R. 1776, which would accelerate the increase in pension contribution and benefit limitations currently being phased in, and remove some of the remaining technical hurdles to full portability among different types of retirement plans, and adopt other reforms. The official summary of the Portman-Cardin legislation is attached. Information regarding the impact of this legislation will be provided at a future meeting.

SUMMARY OF FEDERAL LEGISLATION

Mr. Derman will provide a verbal update at the meeting.

**MEMORANDUM FOR
THE CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM**

Washington Monthly Report

Elk Hills Compensation

I know this is getting old. But it's real money -- \$59 million at stake this year. And we have to fight hard to get it every year.

We are now in the middle of the fight for the sixth annual installment of Elk Hills compensation, having successfully persuaded Congress to appropriate each of the last five annual installments totaling \$180 million. That's \$180 million more than our Congressional opponents thought we would ever get when they required us to walk down the hot path of coals of the Congressional appropriations process each year to get our money.

We have devoted almost all of our efforts on behalf of STRS over the past month to the task of rounding up all 52 members of the California delegation in the U.S. House of Representatives – a group that can only be described as freely diverse in its thinking – to sign on to a letter to the Chairman of the House Interior Appropriations Subcommittee in strong support of an appropriation of \$59 million in Elk Hills compensation for FY 2004. We are pleased to report that, after this month-long effort, all 52 California Members of Congress in the House have signed on to the letter (which is attached to this Monthly Report).

There is a wrinkle this year over the amount of the installment that STRS is due. There is always a wrinkle – because this is Elk Hills. Remember this is the land as to which Edward Doheny was acquitted of giving the bribe that Albert Fall later was convicted of receiving, in the Teapot Dome scandal.

Following payment of the fifth installment of Elk Hills compensation for FY 2003 (funds having been appropriated for payment on October 1, 2003), CalSTRS is owed approximately \$144 million under the Settlement Agreement between the Federal Government and the State. The exact final amount of compensation is subject to finalization of the respective equity interests of the Federal Government and Chevron, the co-owners of the Elk Hills field prior to the sale. In accordance with the Settlement Agreement, the Administration as part of the FY 2000 budget held back \$26 million from the State's share of the Elk Hills sales proceeds deposited in the Elk Hills School Lands Fund, to provide for any

potential downward adjustment in the Federal Government's equity interest. This equity determination process still is being completed, some six years after the sale. The State is entitled to return of this \$26 million "hold-back" if the final equity determination leaves the Federal Government's equity interest unchanged. If the Federal Government's share is increased, the State is entitled to return of the holdback as well as 9 percent of the increase. Informal reports from the equity finalization process continue to suggest that the Federal Government's share as finally determined ultimately will move upward, not downward.

The balance of the Elk Hills School Lands Fund currently stands at \$118 million, after subtracting this \$26 million "hold-back". Under the terms of the Settlement Agreement, for the sixth installment of Elk Hills compensation due for FY 2004 the State is entitled to half of the balance of the Elk Hills School Lands Fund that remains after the holdback. Thus, the State is entitled to \$59 million for the sixth installment. The remainder of the State's 9 percent share of the Elk Hills sales proceeds is due in the subsequent, seventh annual installment.

For FY 2004, the Administration has requested an appropriation of \$36 million as "a placeholder for half of the estimated balance for years six and seven as required by the settlement agreement until final equity finalization [sic.] is complete." (February 2003 Budget Highlights for the Department of Energy FY 2004 Congressional Budget Request, at p. 98). See Budget of the United States Government – Fiscal Year 2004, Appendix, at p. 383-384. The Administration's budget request in effect calls for a second "hold-back" that is contrary to the terms of the Settlement Agreement.

The State Attorney General, after consulting with us, sent a letter in early February to the General Counsel of the U.S. Department of Energy seeking an explanation for the discrepancy in the amount of the sixth installment requested by the Administration. This letter is intended to serve several purposes: (1) to make clear to DoE that we are on to them; (2) to preserve STRS's rights to the full amount in the Elk Hills School Lands Fund and the hold-back that already has occurred, so that DoE or the Hill cannot argue we somehow waived our rights to the full amount of the sixth installment; and (3) to demonstrate to any Congressional appropriator thinking of applying a "haircut" to the sixth installment because of budgetary pressure that such a haircut already has been imposed by DoE. We continue to await DoE's reply some three months later. The initial excuse proffered by DoE for the tardiness of its reply – that the Federal Government had been closed by a snowstorm – seems to have been overtaken by the advent of the cherry blossoms, which are now in full bloom in Washington.

Upon a review of the matter after consultation with us, STRS's long-time Congressional champion on the Elk Hills issue, Chairman of the House Ways and Means Committee Bill Thomas (R-Bakersfield), determined that the appropriations request in the letter to be circulated among the California Delegation should be for the full \$59 million which STRS is owed for the sixth installment, rather than the \$36 million requested by the Administration in its budget request. The attached Delegation Letter makes that request, and that is the path down which we are proceeding.

Senator Feinstein, who serves on the Interior Appropriations Subcommittee in the Senate, has advised us that the Elk Hills appropriation is one of her priority items in appropriations.

We have prepared and filed (following review by STRS staff) written testimony in support of the Elk Hills appropriation with the Interior Appropriations Subcommittees of both the House and the Senate. A copy of the House statement is attached for your reference and background.

Implementation of the Sarbanes-Oxley Corporate Governance and Accounting Reform Legislation

We continue to provide STRS staff with regular written updates on the implementation by the Securities and Exchange Commission of various major components of the Sarbanes-Oxley corporate governance and accounting reform legislation.

The search continues for a Chairman of the new Public Company Accounting Oversight Board, the Securities and Exchange Commission having worked through an initial list of some 450 potential candidates, in consultation with the Chairman of the Federal Reserve and the Secretary of the Treasury, to come up with a "short" list of about a dozen. A final selection is being promised sometime in "the near future".

The SEC on April 1 approved final rules under section 301 of the Sarbanes-Oxley Act which require that the audit committee of a corporate issuer's board of directors, made up of independent directors, be given direct responsibility for the appointment, compensation, oversight, and continued retention of the outside auditor, who must report directly to the audit committee. The audit committee, which must be adequately funded by the corporation, would have the authority to hire independent counsel and other outside advisers. In addition, the audit committee must put into place procedures for handling complaints regarding corporate accounting issues, internal controls, or the performance of the outside auditors.

On related fronts, the SEC staff currently is reviewing the proposals by the New York Stock Exchange and the Nasdaq market regarding listing standards for corporate governance. The SEC staff may seek to make these two sets of corporate governance standards consistent. In other areas, the SEC staff is developing regulations to implement the requirement under the Sarbanes-Oxley Act that management provide in the corporation's annual report an assessment of the effectiveness of the corporation's internal controls and financial reporting system, with the outside auditor being required to attest to that assessment. In addition, the SEC will be developing proposed rules regarding disclosure of critical accounting policies. The SEC is also examining possible changes to Rule 14a-8 regarding shareholder proposals, in an effort to streamline disputes over shareholder proposals and proxy materials.

We will continue to alert STRS staff to key developments in this area as they unfold.

Pension Security Legislation and Pension Liberalization Legislation

Reps. Rob Portman (R-Ohio) and Ben Cardin (D-Md.), who historically have led the bipartisan pension reform effort in the House, introduced on April 11 (on the eve of the deadline for this report) H.R. 1776, the "next generation" of pension reform that is likely to accelerate the increase in pension contribution and benefit limitations currently being phased in, remove some of the remaining technical hurdles to full portability among different types of retirement plans, and adopt other "reforms". (The official summary of the Portman-Cardin legislation is attached.)

We will work with STRS staff to assess the impact of the proposed pension tax law changes on STRS and its various programs.

John S. Stanton
Hogan & Hartson L.L.P.

Washington, D.C.
April 14, 2003

Congress of the United States

Washington, DC 20515

Benefits and Services Committee Item - 9b

Attachment 2

May 8, 2003

March 31, 2003

The Honorable Charles H. Taylor
Chairman
Appropriations Subcommittee on Interior
B-308 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

We are writing to strongly urge the appropriation of funds for FY 2004 to pay the State of California the sixth installment of compensation pursuant to the Federal Government's Settlement Agreement with the State regarding the Elk Hills Naval Petroleum Reserve.

In the Defense Authorization Act for FY 1996 authorizing the sale of the Elk Hills Reserve to private industry, Congress acknowledged the State of California's longstanding claims to the State school lands located within the Reserve by setting aside a portion of the proceeds from the sale of Elk Hills to settle the State's claims and directing the Secretary of Energy to negotiate a settlement of the State's claims. The Settlement Agreement that resulted between the Federal Government and the State enabled the Federal Government to maximize the sales revenues for the Federal taxpayer by removing the threat of the State's claims in advance of the sale as well as any ability of the State to interfere with the sale. In return, the Settlement Agreement provided proper compensation to the State, as Congress had directed, for these lands that had been granted to the State at the time of its admission to the Union. The Settlement Agreement obligates the Federal Government to make installment payments of 9 percent of the sales proceeds as compensation to the State over a seven-year period without interest.

The State of California has kept its part of the bargain under the Settlement Agreement by removing the cloud of the State's claims, which enabled the Federal Government to sell the Elk Hills Reserve for \$3.65 billion, substantially more than had been anticipated. The funds necessary to compensate the State are there, having been collected from the sales proceeds and are now being held in an escrow fund known as the Elk Hills School Lands Fund in the Federal budget for the express purpose of compensating the State, as Congress had directed.

Under the Settlement Agreement, the Federal Government is to make equal installment payments of \$36 million for the first five years. In the final two years of the seven-year agreement, a payment equal to half of the remaining balance is to be made annually. In 1998, 1999, 2000, 2001, and 2002, the entire California House delegation has written to the Chairman of the Interior Appropriations Subcommittee in support of the Elk Hills appropriation of \$36 million. In each of those five years, the California House delegation has been extremely appreciative of the inclusion of these requests in the enacted appropriations bills.

• Again, for the sixth time, the delegation writes in strong support of the Elk Hills appropriation. The balance of the Elk Hills School Lands Fund currently stands at \$144 million, less \$26 million that has been held back pursuant to equity finalization. Under the terms of the Settlement Agreement, for the sixth installment of Elk Hills compensation due for FY 2004, the State is entitled to half of the balance of the Elk Hills School Lands Fund that remains after the holdback. Thus, the State is entitled to \$59 million for the sixth installment (the remainder of the State's 9 percent share of the Elk Hills sale proceeds is due in the subsequent seventh annual installment). We strongly urge the appropriation of \$59 million for FY 2004 to pay to the State of California the sixth installment of compensation to fulfill the Federal Government's current obligation under the Settlement Agreement with the State regarding the Elk Hills Naval Petroleum Reserve.

Best regards,

Sam Lane

Bill Thomas

Doni Dren

Jimmy Lewis

Nancy Pelosi

Buck McKeon

Randy Lick

Don Rader

Bob Filner

Elton Gallegly

Robert J. Hyatt

Jack Hanna

Ch Cox

Ken A. Waxman

Ellen Ocasio

Dori Nuss

Grace J. Napolitano

James J. Walsh

Hank Brown

Lynn C. Woolsey

Julian Furch

Wally Byrd

Ed Royce

Howard L. Berman

George Miller

Louise Roybal-Allard

Tom Lantos

Nicholas Pombro

Brad Sherman

Shoo

Mike Friedman

Mary Jo

Mike Shimpson

Zoe Loh

Diane E. Watson

Don Carls

Pete Stark

Joe Baca

Conrad Schiff

Mike Honda

Hilda L. Solis

Assen Davis

John T. Doolittle

Maxine Waters

Cal Dushy
Samuel H

Joe Cappel

Linda F. Jankins

Barbara Lee

Tony Lee

Loretta Vanekey

Ken Calvert

Ray Shree

WRITTEN STATEMENT OF

**STATE TEACHERS' RETIREMENT SYSTEM
STATE OF CALIFORNIA**

BEFORE THE

**SUBCOMMITTEE ON INTERIOR AND RELATED AGENCIES
HOUSE COMMITTEE ON APPROPRIATIONS**

**Submitted for the Record
April 2, 2003**

**Department of Energy – Elk Hills School Lands Fund: \$59
million for sixth annual installment of Elk Hills compensation**

**Congress Should Appropriate the Funds Necessary to
Fulfill the Federal Government's Settlement Obligation
to Provide Compensation for the State of California's
Interest in the Elk Hills Naval Petroleum Reserve**

Summary

Acting pursuant to Congressional mandate, and in order to maximize the revenues for the Federal taxpayer from the sale of the Elk Hills Naval Petroleum Reserve by removing the cloud of the State of California's claims, the Federal Government reached a settlement with the State in advance of the sale. The State waived its rights to the Reserve in exchange for fair compensation in installments stretched out over an extended period of time.

Following the settlement, the sale of the Elk Hills Reserve went forward without the cloud of the State's claims and produced a winning bid of \$3.65 billion, far beyond most expectations. Under the settlement between the Federal Government and the State, the State is to receive compensation for its claims in annual installments over 7 years without interest. Each annual installment of compensation is subject to a Congressional appropriation. In each of the past 5 fiscal years (FY 1999-2003), Congress has appropriated the funds necessary to pay the \$36 million installment of compensation due for that year.

Congress should appropriate for FY 2004 the \$59 million due as the sixth annual installment payment of compensation under the settlement that Congress directed the Administration to achieve.

The Elk Hills appropriation has the broad bipartisan support of the California House delegation, which has sent a letter signed by the entire delegation to the Chairman of the House Interior Appropriations Subcommittee strongly supporting the \$59 million appropriation for FY 2004.

Background

Upon admission to the Union, States beginning with Ohio and those westward were granted by Congress certain sections of public land located within the State's borders. This was done to compensate these States having large amounts of public lands within their borders for revenues lost from the inability to tax public lands as well as to support public education. Two of the tracts of State school lands granted by Congress to California at the time of its admission to the Union were located in what later became the Elk Hills Naval Petroleum Reserve.

The State of California applies the revenues from its State school lands to assist retired teachers whose pensions have been most seriously eroded by inflation. California teachers are ineligible for Social Security and often must rely on this State pension as the principal source of retirement income. Typically the retirees receiving these State school lands revenues are single women more than 75 years old whose relatively modest pensions have lost as much as half or more of their original value to inflation.

Congressional Direction to Settle the State's Claims

In the National Defense Authorization Act for FY 1996 (Public Law 104-106) that mandated the sale of the Elk Hills Reserve to private industry, Congress reserved 9 percent of the net sales proceeds in an escrow fund to provide compensation to California for its claims to the State school lands located in the Reserve.

In addition, in the Act Congress directed the Secretary of Energy on behalf of the Federal Government to "offer to settle all claims of the State of California. . . in order to provide proper compensation for the State's claims." (Public Law 104-106, § 3415). The Secretary was required by Congress to "base the amount of the offered settlement payment from the contingent fund on the fair value for the State's claims, including the mineral estate, not to exceed the amount reserved in the contingent fund." (*Id.*)

Settlement Reached That Is Fair to Both Sides

Over the course of the year that followed enactment of the Defense Authorization Act mandating the sale of Elk Hills, the Federal Government and the State engaged in vigorous and extended negotiations over a possible settlement. Finally, on October 10, 1996 a settlement was reached, and a written Settlement Agreement was entered into between the United States and the State, signed by the Secretary of Energy and the Governor of California.

The Settlement Agreement is fair to both sides, providing proper compensation to the State and its teachers for their State school lands and enabling the Federal Government to maximize the sales revenues realized for the Federal taxpayer by removing the threat of the State's claims in advance of the sale.

Federal Revenues Maximized by Removing Cloud of State's Claim in Advance of the Sale

The State entered into a binding waiver of rights against the purchaser in advance of the bidding for Elk Hills by private purchasers, thereby removing the cloud over title being offered to the purchaser, prohibiting the State from enjoining or otherwise interfering with the sale, and removing the purchaser's exposure to treble damages for conversion under State law. In addition, the State waived equitable claims to revenues from production for periods prior to the sale.

The Reserve thereafter was sold for a winning bid of \$3.65 billion in cash, a sales price that substantially exceeded earlier estimates.

Proper Compensation for the State's Claims as Congress Directed

In exchange for the State's waiver of rights to Elk Hills to permit the sale to proceed, the Settlement Agreement provides the State and its teachers with proper compensation for the fair value of the State's claims, as Congress had directed in the Defense Authorization Act.

While the Federal Government received the Elk Hills sales proceeds in a cash lump sum at closing of the sale in February, 1998, the State agreed to accept compensation in installments stretched out over an extended period of 7 years without interest. This represented a substantial concession by the State. Congress had reserved 9 percent of sales proceeds for compensating the State. The school lands owned by the State had been estimated by the Federal Government to constitute 8.2 to 9.2 percent of the total value of the Reserve. By comparison, the present value of the stretched out compensation payments to the State has been determined by the Federal Government to represent only 6.4 percent of the sales proceeds, since the State agreed to defer receipt of the compensation over a 7-year period and will receive no interest on the deferred payments.

Accordingly, under the Settlement Agreement the Federal Government is obligated to pay to the State as compensation, subject to an appropriation, annual installments of \$36 million in each of the first 5 years (FY 1999-2003) and the balance of the amount due split evenly between years 6 and 7 (FY 2004-2005).

The Money Is There to Pay the State

The funds necessary to compensate the State have been collected from the sales proceeds remitted by the private purchaser of Elk Hills and are now being held in the Elk Hills School Lands Fund for the express purpose of compensating the State.

Congress has appropriated the funds necessary for each of the previous five annual installments of Elk Hills compensation.

**The President's FY 2004 Budget Request for
the Sixth Annual Installment of Elk Hills Compensation**

Following payment of the fifth installment of Elk Hills compensation for FY 2003 (funds having been appropriated for payment on October 1, 2003), the State is owed approximately \$144 million under the Settlement Agreement between the Federal Government and the State. The exact final amount of compensation is subject to finalization of the respective equity interests of the Federal Government and Chevron, the co-owners of the Elk Hills field prior to the sale. In accordance with the Settlement Agreement, the Administration as part of the FY 2000 budget held back \$26 million from the State's share of the Elk Hills sales proceeds deposited in the Elk Hills School Lands Fund, to provide for any potential downward adjustment in the Federal Government's equity interest. This equity determination process still is being completed, some 6 years after the sale. The State is entitled to return of this \$26 million "hold-back" if the final equity determination leaves the Federal Government's equity interest unchanged. (If the Federal Government's share is increased, the State is entitled to return of the holdback as well as 9 percent of the increase.)

The balance of the Elk Hills School Lands Fund currently stands at \$118 million, after subtracting this \$26 million "hold-back". Under the terms of the Settlement Agreement, for the sixth installment of Elk Hills compensation due for FY 2004 the State is entitled to half of the balance of the Elk Hills School Lands Fund that remains after the holdback. Thus, the State is entitled to \$59 million for the sixth installment. (The remainder of the State's 9 percent share of the Elk Hills sales proceeds is due in the subsequent, seventh annual installment.)

For FY 2004, the Administration has requested an appropriation of \$36 million as "a placeholder for half of the estimated balance for years six and seven as required by the settlement agreement until final equity finalization [sic.] is complete." (February 2003 Budget Highlights for the Department of Energy FY 2004 Congressional Budget Request, at p. 98). See Budget of the United States Government – Fiscal Year 2004, Appendix, at p. 383-384. The Administration's budget request in effect calls for a second "hold-back" that is contrary to the terms of the Settlement Agreement.

The State respectfully requests appropriation of the full \$59 million that it is due for FY 2004 as the sixth installment of compensation under the terms of its Settlement Agreement with the Federal Government.

For more information contact:

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The Pension Preservation and Savings Expansion Act of 2003

Representatives Rob Portman and Ben Cardin

Congress enacted the Portman/Cardin Comprehensive Retirement Security and Pension Reform Act as part of the 2001 tax relief act. This landmark pension legislation, introduced as H.R. 10 in the 107th Congress, increased 401(k) and IRA savings limits, instituted catch-up contributions for older workers, enhanced pension portability through reduced vesting and removal of rollover barriers, encouraged small business pension coverage and simplified pension regulation. The new Portman/Cardin Pension Preservation and Savings Expansion Act builds on these important reforms by making the next generation of improvements to our nation's savings and pension systems. With adoption of these new proposals, Congress will provide individuals and families with a number of important new savings tools, will further strengthen and expand the employer-sponsored retirement system, will offer important new protections to retirement plan participants and will assist retirees in managing and preserving retirement assets and income. The Pension Preservation and Savings Expansion Act contains important reforms in the following areas:

Securing 2001's Retirement Savings Opportunities

- **Making Retirement Savings Opportunities Permanent.** The legislation will make all of the retirement savings and pension reforms contained in the 2001 tax relief act -- from catch-up contributions to portability enhancements to union and teacher pension improvements -- permanent. The 2001 reforms are currently scheduled to sunset at the end of 2010.
- **Accelerating Savings Limits.** The legislation will help Americans step up their retirement savings by accelerating the increases in 401(k) and IRA savings limits contained in the 2001 tax act. The gradual increases in these limits scheduled under current law will instead become fully effective in 2004 so that next year individuals can contribute \$15,000 to their 401(k), \$10,000 to their SIMPLE plan or \$5,000 to their IRA. The catch-up contribution limits will also be accelerated to allow savers age 50 and over to make the full \$5,000 plan catch-up and \$1,000 IRA catch-up beginning in 2004.
- **Expanding and Making Permanent the Saver's Credit for Modest-Income Savers.** The legislation will make permanent the 2001 tax act's credit provided to low and moderate-income savers who contribute to an IRA or workplace retirement plan, which is scheduled to sunset at the end of 2006. This credit, which supplements the existing deduction for IRA or plan contributions, recognizes that modest-income individuals may need additional financial assistance in order to be able to save. The legislation makes more Americans eligible for the credit by increasing single filer eligibility to \$30,000 and joint filer eligibility to \$60,000 and increases the maximum amount of the credit to 60% of the first \$2,000 in contributions.

Improving Pension Fairness and Aiding Savers with Special Needs

- **Reducing Vesting Schedules.** The bill will reduce the required vesting schedule for all contributions made by employers into defined contribution plans (such as 401(k)s) so that these dollars more quickly become the property of the employee. With this change, the vesting schedule for non-matching contributions will be the same as that for matching contributions -- either contributions must vest all at once after three years of service or gradually over six years of service.

- **Ensuring Fair Pension Divisions at Divorce.** The bill will enhance women's retirement security by clarifying that qualified domestic relations orders (awarding a share of a spouse's pension benefits earned during the period of the marriage) issued after a divorce are nonetheless valid and must be obeyed.
- **Allowing IRAs for Disabled Americans.** Today's IRA rules prevent disabled Americans with no wage income from contributing to IRAs and providing for their retirement income needs. Yet some disabled individuals are unable to work and must rely on income from other sources. The legislation corrects this inequity by allowing those who meet a standard definition of disability to contribute to an IRA using income from non-wage sources.
- **Preventing Savings Spend-Down for SSI Eligibility.** In addition, the legislation will ensure that up to \$75,000 of retirement savings do not disqualify the aged, blind and disabled from eligibility for supplemental security income (SSI).

Expanding IRAs

- **Accelerating Eligibility for Deductible IRAs.** In addition to accelerating the IRA limit to an immediate \$5,000, the legislation will speed the gradual increases in income eligibility for traditional deductible IRAs enacted as part of the 1997 taxpayer relief act. This will enable more American families to use this valuable retirement savings tool, which provides an immediate tax deduction for contributions.
- **Eliminating the IRA Marriage Penalties.** Today's rules for both traditional and Roth IRAs impose penalties on married couples because the income eligibility levels for couples are substantially less than twice what they are for individuals. Thus, the very act of getting married makes you less eligible to contribute to these IRAs. The legislation corrects these marriage penalties by ensuring that the income eligibility levels for joint filers are exactly double those for single filers.
- **Correcting IRA Distribution Mistakes.** The legislation will also initiate a correction mechanism to allow IRA investors to return funds to their accounts when distributions have been made in error.

Revitalizing Defined Benefit Plans

- **Replacing An Obsolete Pension Interest Rate.** The legislation will institute a new interest rate benchmark for pension calculations to replace the 30-year Treasury bond rate, which has fallen dramatically as a result of the discontinuation of the 30-year bond. This new benchmark, based on long-term conservative corporate bond rates, will ensure that funding, premium and lump sum calculations are based on a rational and realistic interest rate. The bill will provide very substantial transition assistance to older workers so that expectations regarding lump sum amounts are not undercut.

- **Pension Financing Reforms.** The legislation will provide targeted funding relief for multi-employer pension plans managed jointly by union and employer trustees and will instruct the Treasury Department to update mortality assumptions to more accurately reflect the life expectancy of particular worker populations. It will also correct a number of glitches in the pension funding rules and will correct a flaw in the deduction rules that discourages employers from maintaining both a defined benefit and defined contribution plan.
- **Simplifying Defined Benefit Plan Administration.** The legislation will reform a variety of rules applicable to defined benefit plans that have complicated plan administration and discouraged employers from offering the guaranteed benefits these plans provide. For example, employee contributions to private-sector defined benefit plans will be treated as pre-tax rather than after-tax (as they currently are for public-sector plans) and the plan valuation data collection process would be streamlined.

Preserving Retirement Assets

- **Reforming Required Distribution Rules.** The bill will reform the minimum required distribution rules that force individuals to begin taking their money at age 70½ by raising the starting age to 75 (which will reflect increases in life expectancy since the rule was enacted in 1962). In addition, the excise tax for those who fail to take their proper distributions will be reduced from 50% to 20% of the amount not distributed – enough to deter gaming while avoiding draconian penalties on seniors who make innocent mistakes.
- **Incentives for Lifetime Payments.** More Americans are retiring with lump sum payments from their retirement plans. They face the daunting prospect of making these assets last throughout their lives and the lives of their spouses. Annuitizing some or all of one's retirement savings is an effective way to protect against spousal poverty and outliving one's assets. The bill will allow individuals with income of up to \$90,000 to exclude up to \$2,000 in annual retirement plan annuity income from taxation.
- **Combating Pension Leakage.** Through adoption of fiduciary safe harbors, the legislation will fight leakage from the retirement system by allowing employers to establish easy to use default rollover options -- to either IRAs or annuities -- for departing employees.
- **Reuniting Lost Participants with Retirement Benefits.** The legislation will initiate a new program to help safeguard benefits when employers are unable to locate departing employees who are entitled to pension payments. Employers will be able send the benefits for these "lost participants" to the Pension Benefit Guaranty Corporation, which will use its existing Missing Participants program to match individuals with missing benefits.

Reforming Company Stock and Executive Compensation Practices

- **Providing New Diversification Rights to Employees.** The legislation will contain the Portman/Cardin Employee Retirement Savings Bill of Rights (H.R. 3669 of the 107th Congress). This measure, which was approved by the Ways & Means Committee in April 2002 and reforms retirement plan rules in the wake of the Enron bankruptcy, will provide employees with new rights to diversify company stock contributed to their 401(k) accounts after either three or five years of service (depending on the nature of the contribution). The bill will also direct the Secretary of the Treasury to evaluate possible ways to lessen the effects of market volatility on defined contribution plan savings.

- **Expanding Investment Education, Retirement Planning and Legal Advice.** The bill will also require employers to provide new investment education notices to employees. In addition, the legislation will allow employees to save for retirement planning expenses on a pre-tax basis and will once again treat qualified group legal services on a tax-preferred basis.
- **Preventing Executives from Draining Assets from Failing Companies.** To address the corporate and executive abuses brought to light in recent scandals, the bill will impose an excise tax on excessive corporate payments to senior executives in the period prior to bankruptcy. This will prevent insiders from draining assets from a company as it declines.

Expanding Small Business Pension Coverage

- **Expanding and Improving SIMPLE Plans.** The legislation will make a number of improvements to the existing SIMPLE IRA and SIMPLE 401(k) small business pension design to encourage more small employers to offer retirement benefits to their employees. Employers would be authorized to make additional contributions to SIMPLE plans for all workers, they would be permitted to step up from a SIMPLE plan to a full-fledged 401(k) plan in mid-year, and they would have the low-cost option of setting up a salary-reduction only SIMPLE plan. In addition, SIMPLE 401(k)s would be given the same flexibility on matching contributions as SIMPLE IRAs.
- **Expanding and Improving SEP Plans.** Another important small business pension plan – the Simplified Employee Pension (SEP) -- would be improved. First, a new reverse match SEP would be created. Under this new design, employees would be able to contribute twice what employers contribute to SEP accounts. This will encourage employers to make greater contributions for everyone so that employees can save more with their own dollars. Employers would also be able to make level dollar contributions to SEPs for all workers and families would be encouraged to establish SEPs for domestic workers.
- **Small Retirement Plan Payroll Tax Equity.** Today, unlike large employers, small businesses (proprietorships, partnerships, S corporations) must pay payroll taxes on the employer contributions they make to retirement plans. The bill will end this payroll tax penalty so that small businesses are treated the same way as large corporations, removing a significant disincentive for small businesses to offer retirement benefits to their employees.

Financing Retiree Health

- **Allowing Use of Pre-Tax Pension Payments for Retiree Medical Premiums.** Retiree medical costs are one of the most significant financial burdens faced by older Americans. Today, when a retiree receives a payment from a pension plan and wishes to use that money to pay her retiree medical premium she must pay tax on the pension payment and pay the premium with after-tax money. The bill will allow the retiree to cover her premium with pre-tax pension money, thus putting retirees on the same tax footing as active workers with respect to the tax treatment of their health plan premiums.
- **Allowing 401(k) Sponsors to Pre-Fund Retiree Medical.** One reason more employers do not offer retiree medical coverage is that the ability to pre-fund these benefits is extremely limited. Under the bill, employers with defined contribution plans such as 401(k)s will be given a new mechanism to fund a modest portion of retiree medical expenses on a pre-tax basis.

Enhancing Pension Portability

- **Improving Portability for State and Local Government Employees.** The legislation contains a number of provisions to assist state and local government employees with the portability of their retirement benefits. The purchase of service credit regime -- under which state and local workers can buy discounted pension credits to reflect service in another jurisdiction -- would be improved. In addition, special pension plans for public safety workers that allow employees to roll their pensions over to plan accounts that will continue to grow (so-called “DROP” plans) would be enhanced.
- **Rollovers to Spouses.** To enhance portability and provide new retirement planning tools for married couples, the legislation will allow individuals taking a distribution from their retirement plan and rolling them into an IRA (for example, at job change or retirement) to direct some or all of the distribution to the IRA of their spouse.
- **Rollovers by Non-Spouse Beneficiaries.** Today, when a retirement plan participant dies and the beneficiary is someone other than the participant’s spouse, the plan typically requires the beneficiary to take the benefits in lump sum form, forcing immediate taxation on the full amount. Surviving spouses of retirement plan participants (and all beneficiaries in the IRA context) do not confront this situation and can withdraw benefits over a period of years. The legislation would remedy this problem by allowing non-spouse beneficiaries to roll over the plan benefits to an IRA and take the money out over a period of years consistent with the minimum distribution rules.
- **Rollovers from Flexible Spending Accounts.** Today, employees must either forfeit unused amounts in their flexible spending accounts (FSAs) or spend these amounts (potentially on unneeded health services) before the end of the year. The bill will instead allow employees to roll up to \$500 of unused FSA money into their 401(k), 403(b), 457 or IRA at the end of the year, subject to all the existing limits on plan and IRA contributions.
- **Improving Rollover Rules.** In furtherance of the portability improvements enacted in 2001, the bill will make clear that participants can roll after-tax retirement plan contributions between 401(k)s and 403(b)s when they change jobs and will allow portability of retirement savings between SIMPLE small business plans and other defined contribution plans such as 401(k)s. It will also ease transfers or mergers from 401(k) plans to 403(b) arrangements and vice versa.

Regulatory Simplification

- **Cutting Pension Red Tape.** The bill will continue the regulatory simplification efforts begun in past Portman/Cardin pension bills by reforming a variety of administrative rules that have unnecessarily increased the cost and complexity of retirement plan sponsorship and administration. For example, the bill will improve the IRS’s retirement plan self-correction program, enhance the use of electronic technology for plan operations, and remove barriers that have impeded the adoption of catch-up contributions. The bill does not make any changes to the top-heavy rules.

STATUS OF FEDERAL LEGISLATION AFFECTING CalSTRS

PENSION SECURITY

| BILL/ SPONSOR | STATUS (4/16/03) | SUMMARY |
|-----------------------------------|--|--|
| H.R. 1000 (Boehner) | House Committee on Ways and Means | Would provide additional protections to participants and beneficiaries in individual account plans from excessive investment in employer securities and to promote the provision of retirement investment advice to workers managing their retirement income assets. |
| H.R. 1776 (Portman- Cardin) | House Committee on Ways and Means and House Committee on Education and the Workforce | Would make today's retirement savings opportunities permanent, to expand and improve retirement savings vehicles, to extend pension coverage through regulatory simplification and small business incentives, to enhance fairness and pension portability, to revitalize defined benefit plans, to provide additional defined contribution plan protections, to assist individuals in preserving their income throughout retirement, and for other purposes. |

SOCIAL SECURITY MODIFICATIONS

| BILL/ SPONSOR | STATUS (4/16/03) | SUMMARY |
|-----------------------------|--------------------------------|--|
| S. 349 (Feinstein) | Senate Committee on Finance | Would repeal the Government Pension Offset and Windfall Elimination Provisions |
| S. 363 (Mikulski) | Senate Committee on Finance | Would provide that the Government Pension Offset be equal to the amount by which two-thirds of the total amount of the combined monthly benefit (before reduction) and monthly pension exceeds \$1,200, adjusted for inflation. |
| H.R. 743 (Shaw-Clay Jr.) | Senate Committee on Finance | Would provide additional safeguards for Social Security and Supplemental Security Income beneficiaries with representative payees, to enhance program protections, and for other purposes. Would revise the current "last-day exemption" that allows recipients of non-covered government pensions to work for an employer paying into Social Security for one day prior to retirement in order to be exempt from the Government Pension Offset. The revision requires the worker to work for the participating employer for at least 60 months prior to retirement. |